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No. 356

Supreme Court of the United States

October Term, 1964

THE ACRO MANUFACTURING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Dated: August 6, 1964

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Acro Manufacturing Company respectfully prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Sixth Circuit. That judgment affirmed an order of the Tax Court of the United States determining a deficiency in income tax against the Petitioner for the taxable years 1953 and 1955. If the decision of the Court of Appeals is correct, a parent corporation has the unusual privilege to choose whether the tax incident to the sale of inventories of a subsidiary shall be at capital gain or ordinary income rates.

I.

OPINIONS BELOW

The findings and opinion of the Tax Court reported in 39 T. C. 377, are reprinted at page 74a of the Appendix to Brief for Petitioner in the court below, nine copies of which have been filed with the Clerk.

The opinion of the Court of Appeals, not yet reported, is reprinted as Appendix A hereto, together with its judgment.

II.

JURISDICTION

The judgment of the Court of Appeals was entered on July 8, 1964. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

III.

QUESTION PRESENTED

When a parent corporation receives the inventories and other operating assets of the going business of its wholly-owned subsidiary upon the complete liquidation of the subsidiary and on the same day sells them to another at a loss, is the loss a capital loss?

The Petitioner submits that this question should be answered in the negative.

IV.

STATUTES INVOLVED

Pertinent portions of the Internal Revenue Code of 1954 are reprinted in Appendix B hereto. Statutory citations are to the Internal Revenue Code of 1954.

V.

STATEMENT

During the years in question the principal business of the Petitioner was the manufacture and sale of precision switches and thermostatic controls. In 1954, the Petitioner acquired all the outstanding stock of Universal Button Company (Button), a corporation engaged in the business of manufacturing and selling metal buttons for work clothes.

In 1955, the Petitioner was approached by Talon, Inc. (Talon), which desired to purchase the assets or the outstanding capital stock of Button. The Petitioner was receptive to the approach by Talon because of certain unforeseen difficulties that had arisen in connection with the operations of Button. After negotiation, the Petitioner agreed with Talon that it would cause Button to be completely

liquidated and to distribute all its assets in complete liquidation to the Petitioner, and, upon acquiring such assets, the Petitioner would sell them to Talon, subject to the liabilities of Button, for an agreed price. In accordance with this plan, Button was completely liquidated on June 30, 1955, and the Petitioner, upon receipt of the operating assets, transferred them to Talon and received the purchase price.

The business of Button was actively operated by Button until the time of its liquidation on June 30, 1955, and such business was continued by Talon beginning on June 30, 1955, after Talon acquired the business. There was no interruption in the everyday operations of the Button business during the various transfers described above.

The assets of Button received by the Petitioner and sold to Talon were inventories, accounts receivable and real and depreciable property used by Button in its business. The Commissioner agrees that they were not capital assets in the hands of Button and, if sold at a loss by Button, would have given rise to an ordinary loss in the amount of $557,860.

In its income tax return for the taxable year 1955, the Petitioner reported the sale of the Button assets to Talon as giving rise to an ordinary loss to it in the same amount as if the sale had been made by Button. The Commissioner, in the notice of deficiency, did not disturb the amount of the loss but determined that the loss constituted a capital loss rather than an ordinary loss. The court below and the Tax Court sustained that determination.

VI.

REASONS FOR GRANTING THE WRIT

1.

The Decision Below Unnecessarily Opens a Substantial Tax Loophole

The instant case involves a loss. There is no dispute as to the amount of the loss. By holding that the loss was a capital loss, the court below effectively barred the use of the loss to the Petitioner since the Petitioner did not have any capital gains to be offset by the loss.

If all the assets received by a parent corporation upon the complete liquidation of a subsidiary are converted by the liquidation to capital assets, a sale of such assets at a profit would give rise to capital gain. This appears to be a strange result indeed when such assets include inventories and accounts receivable. It constitutes a triumph of form over substance and imparts to the assets a character entirely unusual and abnormal.

Many business corporations value inventories on the last in-first out method. Obviously, if that method of inventory valuation has been used for a substantial number of years, the carrying value of the inventories is likely to be substantially less than current cost or market value. If a parent corporation desires to sell the assets of a subsidiary and the assets in question include substantially appreciated inventories, the parent, under the rule of this case as decided by the court below, can sell the inventories at capital gain rates by completely liquidating the subsidiary before making the sale. On the other hand, if the inventories can be sold only at a loss, it may cause the subsidiary to sell them and the parent, upon complete liquidation of the subsidiary, may then make use of the resulting ordinary loss under § 381.

The parent thus may choose whether gains or losses are subject to taxation at capital gains or ordinary rates. It is apparent that this choice was not intended by the Congress and therefore the rule of the decision below should be avoided, if possible. The statute, properly interpreted, permits a different result, as we shall see below.

2.

The Same Tax Consequences Should Flow From a Sale of Business Assets Whether the Sale Takes Place Immediately Before or Immediately After the Liquidation of a Subsidiary Corporation.

The Commissioner agrees that, if the subsidiary (Button) had made the sale in this case, it would have sustained an ordinary loss in the same amount as the loss sustained by the Petitioner. To the extent that Button could not have absorbed the loss by carrybacks against its own income for prior years, the Petitioner could have used the loss to offset its own income following liquidation of Button (§ 381). The same tax consequences should obtain when the sale is made by the parent immediately after liquidation of the subsidiary as when the subsidiary itself makes the sale immediately before the liquidation. The Internal Revenue Code supports this result.

Section 332(a) provides that: "No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another [subsidiary] corporation." This provision applies even though the distribution by the subsidiary in liquidation consists solely of cash. *Tri-Lakes S. S. Co.* v. *Commissioner*, 146 F. 2d 970 (6th Cir. 1945).

Section 334(b)(1) provides that, upon liquidation of a subsidiary, "the basis of the property in the hands of the

distributee [parent] shall be the same as it would be in the hands of the transferor. . . ."

Finally, § 1223(2) provides that: "In determining the period for which the taxpayer has held property . . . there shall be included the period for which such property was held by any other person, if . . . such property has . . . the same basis . . . in his hands as it would have in the hands of such other person."

The statutory scheme is clear. The same tax characteristics follow the property into the hands of the parent after receipt in complete liquidation from the subsidiary. No gain or loss is recognized, and the basis and the holding period carry over to the parent. The liquidation is not a taxable event and things go on just as if the subsidiary never existed.

It is true that § 381 provides that an acquiring corporation shall succeed to what are now 23 items specifically set forth in that section, and the classification as capital assets or noncapital assets is not one of the specified items. Section 381, however, "is not intended to affect the carryover treatment of an item or tax attribute not specified in the section. . . ." S. Rep. 1622, 83d Cong., 2d Sess., 277 (1954).

The Commissioner and the court below seek to thwart the statutory scheme by a liberal construction of § 1221, defining capital assets. A capital asset is there defined to mean all property held by the taxpayer with certain specified exceptions. These exceptions include inventory, real property and depreciable property used in a trade or business and accounts and notes receivable acquired in the ordinary course of business for services rendered or from the sale of inventory. The court below concluded that, the property here in question was not used in the business of the Petitioner, because it was engaged in a business different from

that of its wholly-owned subsidiary, and, therefore, the property did not fall within the specified exceptions and must be characterized as capital assets. The exceptions were thus narrowly construed and the definition of capital assets broadened.

But this Court on numerous occasions has pointed out that the definition of capital asset should be construed narrowly and the statutory exceptions should not be interpreted literally. The exceptions should be interpreted broadly in accordance with the purpose of the Congress to afford capital gains treatment only in situations typically involving realization of appreciation in value of investments accrued over a substantial period of time. *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U. S. 130 (1960); see also *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46 (1955). And certainly in the case of inventories, there was, in fact, no such appreciation over a substantial period of time.

The statutory scheme relating to the tax consequences resulting from the liquidation of subsidiary corporations should not be thwarted by a literal reading of the capital asset definition in § 1221, and it need not be. Within common understanding, the business of a parent corporation includes the business of its subsidiary corporations. This is not to pierce the corporate veil. In *Fairfield S. S. Corp.* v. *Commissioner*, 157 F. 2d 321, 323 (2d Cir. 1946), *cert. den.*, 329 U. S. 774 (1946), Judge Learned Hand said about the tax treatment of a subsidiary liquidation:

> ". . . the underlying purpose was to permit the union in one corporate form of a single business or venture which had theretofore been managed by two corpo-

> rations—the transferee holding all the shares of the transferror [*sic*]."[1]

Section 1223(2) provides that the Petitioner held the property during the period that it was held by the subsidiary. This court has said that "to hold property is to own it." *McFeeley* v. *Commissioner*, 296 U. S. 102, 107 (1935).

In every realistic sense, the Petitioner was in the button business because its wholly-owned subsidiary was in the button business. From an economic point of view, the Petitioner owned and managed the property while it was being used in business. As the court below said, this is the way that "the public generally regards" a situation of this character (p. 17). As this Court has said:

> ". . . statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributed to them." *DeGanay* v. *Lederer*, 250 U. S. 376, 381 (1919).

The court below did not follow this rule. Had it done so, even with its literal approach, the property sold in this case should not be categorized as capital assets. This court should take this opportunity to establish the important principle of income tax law that a sale of property, whether immediately before or immediately after the liquidation of a subsidiary corporation, gives rise to the same tax consequences under the mandate of Congress contained in §§ 332 and 334(b)(1) of the Internal Revenue Code.

---

[1] The holding in that case, now of questionable standing (cf. *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451 (1950)), has no application here for the Commissioner has not determined that the loss at issue here should be attributed to Button.

VII.
CONCLUSION

This is a case of first impression. As the court below pointed out, no reported case decides this issue. The case presents an important question of federal law which has not been, but should be, settled by this Court.

Accordingly, the Petitioner prays that a writ of certiorari issue to bring before this Court for review the judgment of the court below.

Respectfully submitted,

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Dated: August 6, 1964

APPENDIX A

OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Opinion

Decided July 8, 1964.

Before: MILLER, Circuit Judge, and WEINMAN and KAESS, District Judges.

MILLER, Circuit Judge. The taxpayer, the Acro Manufacturing Company, sought a redetermination in the Tax Court of its income tax liability for the years 1953 and 1955. The issue involved is whether a loss in the amount of $557,860.00, sustained by the taxpayer in 1955, was an ordinary loss or a capital loss. If it was an ordinary loss, the taxpayer had a net operating loss for the year 1955, which can be carried back to 1953. If the loss was a capital loss, the taxpayer owed additional taxes for the year 1955 in the amount of $239,026.78.

The facts are stipulated and are set out in detail in the findings and opinion of the Tax Court reported at 39 T.C. 377. The following summary is sufficient for our present purposes. During the years in question the principal business of the taxpayer was the manufacture and sale of precision switches and thermostatic controls. On December 9, 1954, it acquired all the outstanding stock of Universal Button Company (hereinafter referred to as Button) solely in exchange for 55,000 shares of its own voting common stock. Button was engaged in the business of manufacturing metal buttons for work clothes.

In March 1955 the taxpayer was approached by Talon,

Inc., (hereinafter referred to as Talon) for the purpose of purchasing the outstanding capital stock of Button. The taxpayer was receptive to this idea because of certain unforeseen difficulties that had arisen in connection with the operation of Button, but was unwilling to sell the Button stock to Talon because of what it considered undesirable income tax results. The taxpayer and Talon finally agreed that the taxpayer would cause Button to be completely liquidated and to distribute its assets, property and good will to the taxpayer in such complete and final liquidation, and that the taxpayer, upon acquiring such assets, would sell them to Talon subject to the liabilities of Button, for an agreed price. In accordance with this plan, Button was completely liquidated on June 30, 1955, and the taxpayer, upon receipt of the operating assets, immediately transferred them to Talon, in accordance with the terms of their agreement.

The business of Button was actively operated by Button until the time of its liquidation on June 30, 1955, and was continued by Talon beginning on June 30, 1955, after it acquired the business. There was no interruption in the everyday operations of the Button business due to the various transfers described herein, which took place on June 30, 1955.

The assets of Button received by the taxpayer and sold to Talon were inventories, accounts receivable, and real and depreciable property with respect to the business carried on by Button. It is agreed by the parties that they were not capital assets in the hands of that corporation, and if sold at a loss by that corporation would not have constituted a capital loss.

In its income tax return for the taxable year 1955 the taxpayer reported this transaction with Talon as an ordi-

nary loss, as it would have been if the sale had been by Button. The Commissioner, in the notice of deficiency, determined that the loss constituted a capital loss rather than an ordinary loss. The Tax Court sustained this determination. It is this issue which is before us on the present petition for review.

The parties are unable to refer us to any other reported case deciding this exact issue. The taxpayer claims, however, that the statutory provisions applicable to assets received by a parent corporation in the complete liquidation of a subsidiary corporation clearly show that it is the intent and purpose of Congress that such assets are to be received and held by the parent corporation in the same taxable status as they were held by the subsidiary corporation before liquidation.

In support of this contention, taxpayer refers to the following sections of the Internal Revenue Code of 1954.

Section 332(a) provides, "No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation."

Section 334 (b) (1) provides, "If property is received by a corporation in a distribution in complete liquidation of another corporation . . . the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor."

Section 1223 (2) provides, "In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other persons."

It is argued that these statutory provisions make it clear that upon the complete liquidation of a subsidiary the parent is to step into the shoes of the subsidiary, and since a sale of the assets by Button would not have been treated as a sale of capital assets, a sale by the taxpayer should be treated the same way.

The Commissioner, of course, recognizes these statutory provisions. However, he points out that although they provide that the parent steps into the shoes of the subsidiary insofar as certain designated tax consequences are involved, they do *not* provide that noncapital assets in the hands of a subsidiary shall remain noncapital assets in the hands of the parent corporation after they have been received in complete liquidation. On the contrary, he points out that whether assets are capital assets or noncapital assets is expressly controlled by Section 1221 of the Internal Revenue Code, the provisions of which, insofar as they are applicable to our present question, are as follows:

> "Sec. 1221. *Capital asset defined.*
> "For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> "(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;
>
> "(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;
>
> * * * * * *

"(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1) . . ."

We are of the opinion that the Commissioner's argument is sound on this phase of the case. Although it is true that Congress intended that the parent corporation was to step into the shoes of the subsidiary upon a complete liquidation of the subsidiary, insofar as no gain or loss should be recognized in the transaction, that the basis of the property in the hands of the parent corporation should be the same as it was in the hands of the subsidiary corporation, and that the holding period of the subsidiary corporation should be added to the holding period of the parent corporation, this does not justify the conclusion that Congress intended that noncapital-assets [*sic*] held by a subsidiary corporation will continue to be noncapital assets in the hands of the parent corporation when there is an express statutory provision which lays down the standards for determining whether assets are noncapital assets or capital assets. In other words, we are necessarily controlled by an express statutory provision, which is in no way repealed by the statutory provisions relied upon by the taxpayer. Accordingly, the question presented is whether the assets received and sold by the taxpayer were capital assets under Section 1221 of the Internal Revenue Code. It is clear from the wording of the section that they were capital assets unless they fall within one of the exceptions therein set out, namely, stock in trade or inventory, depreciable property or real estate used in trade or business, or accounts receivable acquired in the ordinary course of trade or business. We are not concerned whether these assets meet this test in the hands of Button, which the Commissioner concedes to be the case,

but the question is whether these assets meet this test in the hands of the taxpayer after the taxpayer acquired them from Button and at the time it made the sale to Talon. We do not believe it can be said that tangible assets received from Button can be considered stock in trade, inventory, or property used in the business of the taxpayer. The business of the taxpayer was the manufacture and sale of precision switches and thermostatic controls. Nor do we believe that the accounts receivable received from Button were acquired in the ordinary course of trade or business for services rendered or from the sale of property as that term is generally understood.

The taxpayer attempts to meet this situation by claiming that it in fact owned, operated and used in its business the assets received from Button for a short period of time on June 30, 1955, between the time when those assets were distributed to it upon the liquidation of Button and the time when the assets were transferred to Talon. We agree with the ruling of the Tax Court that the ownership of these assets for such a minimal, transitory period of only a few hours at the most was insufficient to establish use of the assets in the taxpayer's business or to place the taxpayer in the button business within the meaning of the statutory provision. It was clearly not the intent of the parties that the taxpayer was to engage in the button business, and we are not advised of any showing by the taxpayer's corporate records that it manufactured in whole or in part or sold any buttons on June 30, 1955, including, among other things, cost of manufacture and payment of wages to Buttons' employees.

The taxpayer further argues that by reason of its ownership of the stock of Button, it was in the business of manufacturing buttons. It calls attention to the fact that the

Standard Oil Company of New Jersey, which is a holding company with no operating assets, is nevertheless in the oil business, and that the American Telephone and Telegraph Company, which is a holding company with no operating assets, is nevertheless in the telephone business. That, of course, is the way in which the public generally regards these two companies, but that in no way negatives the fact that they are holding companies and not operating companies, and that their corporate entities as holding companies are separate and distinct from the corporate entities of the subsidiaries which they own. For the purposes of the statute which we are here considering, we do not consider the taxpayer to have been in the button business by reason of the fact that it owned the stock of a subsidiary corporation which was engaged in that business.

In effect we are urged by the taxpayer to treat its sale transaction as though it were made by its subsidiary. But it was not a sale by the subsidiary, even though the assets were acquired from the subsidiary by the taxpayer by reason of its stock ownership of the subsidiary. Unless we ignore the separate corporate entities of the taxpayer and the subsidiary, which, in our opinion, we are not authorized to do, the sale must be treated for income tax purposes as a sale by the taxpayer. *Moline Properties, Inc.* v. *Commissioner,* 319 U. S. 436; *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422.

Our views in this matter are very much in accord with those expressed by the Tax Court. Without enlarging upon this opinion, we refer to the distinction made by that Court between the present case and the authorities relied upon by the taxpayer.

The decision of the Tax Court is affirmed.

Judgment

(Filed July 8, 1964)

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

No costs awarded. Rule 23(4).

Approved for entry:

SHACKELFORD MILLER, JR.
United States Circuit Judge

APPENDIX B

RELEVANT SECTIONS OF THE INTERNAL REVENUE CODE OF 1954

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RELEVANT SECTIONS OF THE INTERNAL REVENUE CODE OF 1954

(Title 26, United States Code)

§ 332(a) and (b):

(a) GENERAL RULE.—No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

(b) LIQUIDATIONS TO WHICH SECTION APPLIES.—For purposes of subsection (a), a distribution shall be considered to be in complete liquidation only if—

(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends); and either

(2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year. . . .

§ 334(b):

(b) LIQUIDATION OF SUBSIDIARY.—

(1) IN GENERAL.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), then, except as provided in paragraph (2), the basis of the property in the hands

of the distributee shall be the same as it would be in the hands of the transferor. . . .

§ 381(a) and (c):

(a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2);

* * *

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c.).

* * *

(c) ITEMS OF THE DISTRIBUTOR OR TRANSFEROR CORPORATION.—The items referred to in subsection (a) are:

(1) NET OPERATING LOSS CARRYOVERS.—The net operating loss carryovers determined under section 172. . . .

§ 1221:

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in

the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

* * *

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1). . . .

§ 1223(2):

For purposes of this subtitle—

* * *

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

§ 1231(a) and (b):

(a) GENERAL RULE.—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business . . . exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held

for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. . . .

(b) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—For purposes of this section—

(1) GENERAL RULE.—The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. . . .